

Mr Andrew Tyrie MP,  
Chairman,  
Treasury Committee  
7 Millbank  
House of Commons  
London SW1P 3JA

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## **Further Evidence to the Treasury Committee Inquiry into financial regulation**

At the inquiry proceedings on 18 November you asked a number of questions about the Panel's role currently and what we envisage for the future and encouraged all the Panels to come back and provide more information in relation to the costs and benefits of regulation and the role of the Bank of England in the new structure. This further information is provided below.

### ***Clarification of the role and remit of Panel and its role in transition and in the future.***

1. The Financial Services Consumer Panel (FSCP) is a statutory body by virtue of s10 of the Financial Services and Markets Act 2000 (FSMA 2000). Initially established by the Financial Services Authority (FSA) in December 1998, the Panel advises the FSA Board on the interests and concerns of consumers, including SMEs', and reports on the FSA's performance in meeting its objectives in the regulation of financial services.
2. The emphasis of the Panel's work is on activities that are regulated by the FSA, although it may also look at the impact on consumers of activities outside, but related to the FSA's remit. The Consumer Panel works to advise and challenge the FSA from the earliest stages of its policy development to ensure the FSA takes the consumer interest into account. The Panel also takes an interest in broader consumers issues in financial services where it believes it can help achieve beneficial outcomes and where it thinks there is a lack of consumer representation. This is an important role; the consumer interest in the financial services sector is not well represented by consumer bodies because of their focus on particular issues relevant to their membership and their limited resources for research.
3. Members of the Panel are recruited through a process of open competition and encompass a broad range of relevant expertise and experience. FSMA 2000 provides that the Panel membership must have a fair degree of representation to consumers of financial services<sup>1</sup>. There are currently eleven members of the Panel as listed below and these positions change every 3 years on rotation.

Adam Phillips (Chairman)  
Kay Blair (Vice Chairman)  
Stephen Crampton  
Bill Martin

Caroline Gardner  
Tony Hetherington  
Nick Lord  
Claire Whyley

David Metz  
Lindsey Rogerson  
Mike Dailly

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<sup>1</sup> FSMA 2000 s10(6)

## Terms of Reference

4. The Financial Services Act 2000 provides that the FSA must have regard to any representations made to it by the Panel<sup>2</sup> and that it must consider any representation made to it by the Panel<sup>3</sup> and if the FSA disagrees with a view expressed, or proposal made, in the representation, it must give the Panel a statement in writing of its reasons for disagreeing.<sup>4</sup>
5. Beyond its statutory basis the Consumer Panel has a Memorandum of Understanding with the FSA and formal terms of reference set out its role and responsibility as follows:
  1. The Financial Services Consumer Panel ('the Panel') is established by the Financial Services Authority (FSA) under the Financial Services and Markets Act to represent the interests of consumers. The Panel is independent of the FSA and can speak out publicly on issues where it considers this appropriate.
  2. Panel members are appointed by the FSA, in accordance with Nolan principles in order to represent consumers, with HM Treasury's approval in the case of the Chairman. The FSA Board approves the Panel's annual budget and provides a dedicated secretariat to support the Panel.
  3. The main purpose of the Panel is to provide advice to the FSA. As such it does not carry out responsibilities on behalf of the FSA. For example, the Panel does not undertake consumer education, nor does the Panel take up individual consumer complaints.
  4. The emphasis of the Panel's work is on activities that are regulated by the FSA, although it may also look at the impact on consumers of activities outside but related to the FSA's remit
  5. The Panel will have regard to the interests of all groups of consumers including those who are particularly disadvantaged in the context of financial services, including consumers who have little or no access to financial services.
  6. The Panel will:
    - a. represent the interests of consumers by advising, commenting and making recommendations on existing and developing FSA policy and practices as appropriate;
    - b. speak on behalf of consumers by reviewing, monitoring and reporting to the FSA on the effectiveness of FSA's policies and practices in pursuing its duties;
    - c. keep under review and influence actual and potential developments in financial services to enable it to fulfil (a) and (b) effectively.
  7. In addition, it can advise the Government on the scope of financial services regulation.

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<sup>2</sup> FSMA 2000 s10(4)

<sup>3</sup> FSMA 2000 s11(2)

<sup>4</sup> FSMA 2000 s11(3)

8. The Panel can consider other matters that assist it in carrying out its primary functions.
9. The Panel shall publish an Annual Report on its work and expenditure.
10. The Panel can speak out publicly when it wishes to draw attention to matters in the public interest and when it disagrees with the FSA.

### **Limitations to the Current Role of the Panel**

6. From the above terms of reference and the wording of the statute it is clear that the Consumer Panel's focus has been on advising, influencing, supporting and challenging the FSA rather than having a more public campaigning role. The Panel's powers are related principally to this internal lobbying role rather than having external powers of public persuasion or a campaigning objective. However this role is significant because it is an opportunity to influence thinking, to represent the consumer interest and advance the cause of consumer protection as a counter to the industry's powerful lobbying machine.

### **Role of the Panel in the transition**

7. During the transition to the new twin peaks model of regulation the Consumer Panel will continue to discharge its role. We will be specifically concerned to ensure that current consumer protection initiatives are carried through and the more interventionist, outcome approach to regulation comes to fruition.
8. We will want to ensure that stated commitments to improved regulatory outcomes and the new approach to the regulation of conduct of business are taken forward and indeed gather momentum, that the organisation maintains sufficient resources and expertise to operate effectively and that the transition does not distract it from its regulatory functions.
9. As an adviser to the FSA the Panel anticipates that it will be influential in ensuring that the new Consumer Protection and Markets Authority has the powers to act as an effective champion of the consumer interest delivering more effective consumer protection than has been the case with the FSA. We will advocate the cultural change necessary for the elements of the FSA which transfer to the CPMA to develop their consumer protection credentials, their expertise, an effective approach to consumer engagement, improved transparency and to develop effective accountability mechanisms in the new structure. We will also be advocating the development of formal processes for co-ordination and communication between the peaks to ensure the benefits of an effective supervisory approach are not lost and that overlap/underlap does not occur.

### **Future Role of the Panel**

10. We have argued in our evidence to the HM Treasury consultation that the Panels need to be given an enhanced role under the new structure. Specifically we have suggested that the Consumer Panel be given greater resourcing in the transitional stages, of which the FSA have been supportive, so that it has the power to more strongly represent the consumer interest. We will also need to consider the powers and resources required for the future role, particularly as it will be dealing with a new and evolving structure and should have formal relationships with the FPC and PRA.

We have also argued that the Panel should regularly appear before the House of Commons Treasury Committee to ensure greater accountability for the new regulators to Parliament.

11. We expressed this in our evidence to the HM Treasury consultation as follows:

*59. We believe the role of the Panels should be enhanced in the new regime to improve the CPMA's governance. In particular, we would like to see increased and effective Panel resourcing and a stronger obligation on the CPMA through statute to consult and take note of the Panel's recommendations and challenges.*

*60. Moreover, the three Panels representing consumer and practitioner interests should not only provide input to the CPMA. We believe the Panels have become an effective part of the FSA's governance structure and should be enabled to advise the FPC and PRA, to ensure that consumer and practitioner interests are adequately represented. When applicable, the FPC and PRA should have a duty to liaise with and consult the Independent Panels to ensure that there is proper scrutiny of decisions.*

*61. Specifically in the case of the Consumer Panel, we recommend that it has a formal duty to report to the Treasury Select Committee on a regular timetable.*

12. Responses to the Treasury consultation supported an obligation on the regulator to consult and reflect on views from the Panels in relation to key decisions and to ensure that there was greater transparency as to how the regulator would take account of the panels' recommendations. Requiring this would assist our role.

13. A key element of the Panels' ability to provide effective oversight and challenge to the CPMA and PRA will be the power to request information relevant to the performance of their role. At present, the Panels do not have this power. It is therefore possible for the regulator to refuse to answer questions in a way which obstructs the work of the Panels. This has not happened in the history of the relationship with the FSA, but the new less integrated architecture means that this power will be essential to ensure the exercise of effective governance.

### **Costs and benefits of regulation**

14. The Panel's evidence emphasised the need for effective and efficient regulation. Our concerns about the costs of regulation relate to the likelihood that increased regulatory costs will be borne by consumers. It remains in the consumer and public interest to have effective regulation and it is important that the value of regulation is given proper recognition in public debate rather than being constantly portrayed as a burden on business.

15. Regulation protects and acknowledges good players. The extent of regulation is often equated with the extent of market failure. The work commissioned by the FSA and the Practitioner Panel on the costs of regulation confirms that much of what regulation requires is good business practice and that separating costs of regulation versus business as usual is difficult and often arbitrary.<sup>5</sup> Treating customers fairly,

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<sup>5</sup> Deloitte, The cost of regulation study. Commissioned by the Financial Services Authority and the Financial Services Practitioner Panel, 2006.

good complaint handling, transparency about performance and meeting consumers' information requirements are all examples of what customers would expect in a retail environment where competition is effective at delivering products and services which are good value and which meet customers' needs.

16. The level of intervention currently required in these areas points to a failure of culture and a lack of embedding of a consumer perspective in financial service and product provision. Where the market is failing to deliver good outcomes for customers the cost of regulation is high and the regulator is in effect pressing the industry to introduce good business practise in those firms where they are not already embedded.
17. The real cost of regulation to society is in the failure to regulate effectively. The social and economic impact of withdrawing financial services is underlined by Government measures to ensure their continuance. A good example is the impact of exclusion from access to transactional banking services which are now effectively a utility. Utilities have to be regulated so that charges are kept to a reasonable level and the poor do not pay more. Transactional banking is an obvious example of where intelligent regulation is needed , but Investments and long term savings are necessary for individuals and the economy, the terms on which people engage with these can not be left solely to a market which inevitably services only the more profitable segments.
18. As the report by the Better Regulation Executive for the Department of Business, Innovation and Skills pointed out:

*“But looking at costs alone distorts the picture. Better regulation also seeks to maximise the ‘net benefit’, i.e. benefit minus costs. Although regulation may have a cost for society it is intended to deliver benefits and can have an overall positive effect for society. For example, competitive markets create benefits like extra trade and reduced prices. Regulation means cleaner air and water, safer workplaces and food as well as the safety net created by the minimum wage.”<sup>6</sup>*

19. The analysis of the benefits of regulation has often been weak and driven by quantitative rather qualitative analysis. This is particularly so in the area of consumer risk, evidenced by examples such as the proliferation of mis-selling and competition concerns associated with PPI and the unfair level of charges on bank accounts. The FSA's report on assessing the benefits of regulation recognised that direct benefits are often difficult to quantify and set out a complicated framework for identifying metric that can be used to proxy for final market outcomes.<sup>7</sup> We welcome instead the FSA's commitment to producing a Conduct Risk Outlook.<sup>8</sup> We hope that this will provide a framework to identify conduct issues before significant detriment arises for consumers, and to frame a dialogue with firms and consumer groups on these issues. We look forward to this producing a more realistic basis for establishing the benefits of regulating financial services.
20. There is an opportunity to re-energise the better regulation agenda by putting the consumer interest at the heart of regulatory policy and practice. The House of

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<sup>6</sup> BIS, Better regulation, better benefits: getting the balance right, October 2009, 7.

<sup>7</sup> Oxera, A framework for assessing the benefits of financial regulation, Report prepared for Financial Services Authority, June 2006.

<sup>8</sup> Adair Turner, Speech to the BBA, Protecting Consumers and Winning Trust, 13 July 2010.

Commons Regulatory Reform committee urges more accountability to citizens and end users, a view supported by the FSA report on the benefits of regulation which notes that in order to achieve some of the benefits of regulation incentives between Financial Services firms and their customers need to be better aligned.<sup>9</sup>

### ***New structure vests too much power in role of Governor/Central Bank***

21. We believe proper resourcing, increased accountability, effective governance and good communication and co-ordination between regulators will be the key in delivering effective regulation no matter what the structure. However, we have expressed reservations about the implied hierarchy in the proposed system and expand below on some of the issues in relation to a central bank carrying out the prudential regulation functions.

20.1 Central banks have traditionally not been particularly open or transparent about their operations. The new role will be quite a culture change for the Bank. The Panel has been advocating reform in the area of transparency in the FSA for a long time and while some progress has been slow. Transparency, accountability and consumer engagement need to be features of the new regulatory structure from Day 1. While we welcome the proposed accountability mechanisms for the PRA there needs to be a specific consumer/public perspective, proper impact assessment and a focus on accessible communication. At the very least the PRA should be subject to the same accountability mechanisms proposed for the CPMA. We will expect to see, in the words of the IMF, robust mechanisms to ensure transparency and a high degree of accountability of the Central Bank's actions in practice.

20.2 The perception of the Bank acting as a narrow advocate of city interests remains rather than an institution accountable to Government. John Kay talks of the Bank of England acting as a

“co-ordinator of a self-regulating club of financial institutions. The implicit deal was that financial institutions were permitted to act as a cartel in return for a commitment to conservative behaviour. In times of difficulty they would provide mutual support, which the Bank would co-ordinate, in order to maintain financial stability.”<sup>10</sup>

20.3 The main concerns of the Consumer Panel in relation to FPC and the PRA are regarding the composition of the boards, with an overly strong Bank of England and industry basis and the lack of a consumer or broader public policy perspective. We would not want to see the supervision of business conduct downgraded as a result of the structural changes and a failure to adequately consider the possible negative impact on citizens.

20.4 Research has indicated that central banks that are also responsible for bank regulation will be more sensitive to the profitability of the banking sector and

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<sup>9</sup> Oxera for the FSA, as above.

<sup>10</sup> John Kay, The new financial services leviathan: has competition been a casualty of the financial crisis? in Rethinking Financial Services, Consumer Focus, June 2010.

therefore less likely to alter interest rates solely on the basis of financial stability objectives.<sup>11</sup>

20.5 The FSA was broadly criticised for its failure to balance competing objectives. The Bank of England will be placed in a similar position and will need to be clear as to how this conflict will be managed from the outset. We are concerned that too narrow a focus on the stability of the banking system could be unnecessarily damaging to sections of the population. It is not clear that there is adequate or effective public accountability in the proposed structure.

20.6 The formal mechanisms for communication and co-ordination across the regulatory system are yet to be detailed. There remains an area of overlap in prudential regulation between PRA and CPMA and there are some significant co-ordination issues to address.<sup>12</sup>

I hope this information is helpful and please let me know if there is any further clarification you need.

Yours sincerely

**Adam Phillips**  
Chairman

*Attachments: Retail Banking: Position Paper  
Regulation of Retail Banking Conduct of Business, A review of the first year of  
the new regulatory framework  
The Financial Services Consumer Panel Response to CM 7874*

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<sup>11</sup> Mark S Copelovitch and David Andrew Singer, Financial Regulation, Monetary Policy and Inflation in the Industrialized World." The Journal of Politics, Vol 70, No.3, July 2008, pp 663-680

<sup>12</sup> The Australian twin peaks model has separate prudential and conduct regulators in addition to the Central Bank who all have representation, along with the Treasury on an overarching Council of Financial Regulators. Similarly the recommendations of the Canadian Expert Panel on Securities Regulation suggest the need for a permanent co-ordinating body that will promote co-ordination of regulatory policy. Eric J. Pan, *Structural Reform of Financial Regulation in Canada*, A Research Study Prepared for the Expert Panel on Securities Regulation.